

## TARP Was a Response to Non-Bank Problems

It is important to remember the history of the Troubled Asset Relief Program (TARP) and its Capital Purchase Program (CPP). The genesis of this government intervention was the severe problems at firms that were *not* banks, such as Bear Stearns, Fannie Mae and Freddie Mac, and AIG. While the problems have spread to include some banks, the vast majority of banks never made a toxic subprime loan, and these banks remain strong despite the spreading economic downturn.

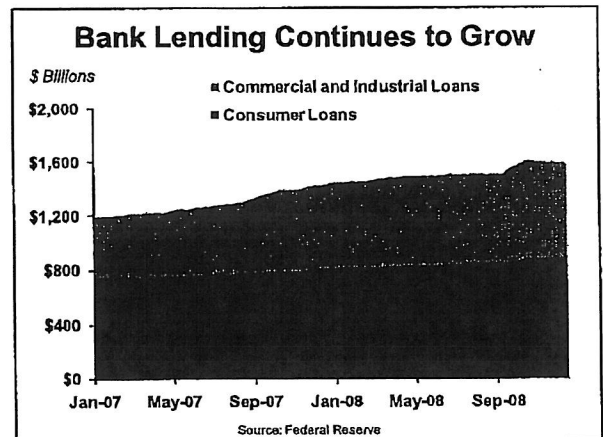
The U.S. action to inject capital into healthy banks through the CPP was also a response to foreign governments acting to support institutions that were far less capitalized than U.S. banks. U.S. banks typically had three times the capital of their foreign counterparts and twice the capital of Wall Street investment banks. In fact, roughly 95 percent of U.S. banks are well-capitalized.

### Capital Injection Can Support New Lending

Treasury provided investments in banks to build strong capital to withstand a deep recession and to support new lending. One dollar of capital can support much more than \$1 of lending – up to \$7. This can help communities where these banks are located. However, the impact is not immediate. New loans need to be funded with new deposits, which have to be raised. Moreover, many banks that applied have yet to receive their funds, and more than one-third of banks, until very recently, have had no opportunity to apply to the CPP as Treasury had not released the term sheets for certain types of banks, such as mutual savings banks. At this point, less than five percent of banks have CPP funding. It is estimated that less than 25 percent will choose to participate.

### Banks Continue to Lend

Banks want to lend – that is how they make money. But demand is down, which is expected as many businesses and individuals are reluctant to take on debt in a weak economy. Creditworthy borrowers are getting loans. The National Federation of Independent Businesses recently found that only 7 percent of small businesses reported problems in obtaining the financing they desired. Borrowers that used to rely on non-bank financing or Wall Street are also coming back to banks. Naturally, banks are following prudent underwriting standards on these and other new loan opportunities to avoid losses in the future and bank regulators demand they do so.



### *The Need for Clarity*

Much of the confusion about the CPP program is a result of the ever-changing nature of TARP and the various uses of TARP funds. There need to be clear-cut distinctions between programs within TARP. For example, the CPP should be separated from programs to address problems or even potential failures of systemically important institutions. The current confusion is harmful. Only by clearly identifying the programs can there be proper Congressional oversight and effective policymaking. The public's confusion undermines confidence in the efforts to turn around the economy. Finally, the costs of each program should be separately determined. The CPP program is different from systemic risk support, as the side-by-side table on the next page shows.

Comparison of The Capital Purchase Program and Other TARP Programs	
Capital Purchase Program	Other TARP Systemic Risk Programs
For institutions that are <i>healthy</i> at the time investments are made; explicitly <i>not</i> for troubled or failing companies.	For companies considered to <i>pose systemic risk</i> that request government assistance.
The government created the program; the banking industry did not ask for it.  <i>Voluntary</i> , but government has requested that some banks participate.	Companies <i>ask</i> for rescue.
Purpose is to <i>stabilize financial markets</i> by providing capital to healthy institutions and increasing the flow of credit to businesses and consumers.	Purpose is to <i>aid companies thought to be in difficulty</i> that could have a systemic impact.
<i>Government determined same terms for all participants.</i> No input on terms from participants.	Rescues have been <i>individually negotiated with participants.</i>
Government <i>certain</i> to receive tens of <i>billions of dollars</i> from dividends paid by participants on CPP investments. Warrants will almost certainly be worth billions more.	Final <i>cost</i> of government actions <i>uncertain.</i>
<i>Designed with exit strategy.</i> Strong financial incentive for institutions to pay off government investments within <i>five</i> years.	<i>Exit strategy uncertain.</i> How government involvement ends is in some cases uncertain.